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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1929.

THE UNITED STATES,

Petitioner,

v.

AMERICAN CAN COMPANY.

THE UNITED STATES,

Petitioner,

v.

MISSOURI CAN COMPANY.

THE UNITED STATES,

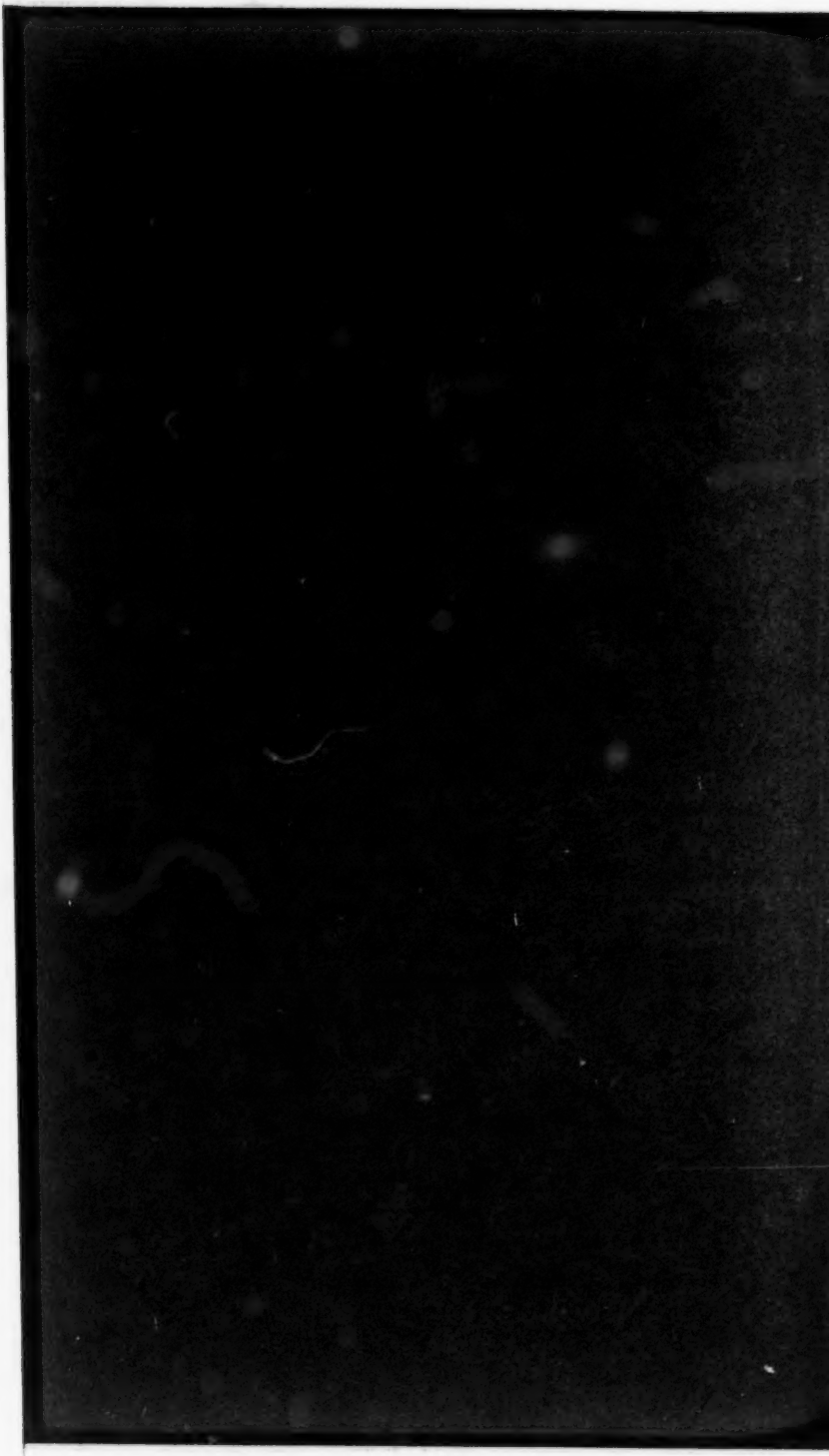
Petitioner,

v.

DETROIT CAN COMPANY.

BRIEF FOR PLAINTIFFS-RESPONDENTS.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.



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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1929.

Nos. 128, 129, 130.

THE UNITED STATES,
Petitioner,

vs.

AMERICAN CAN COMPANY.

THE UNITED STATES,
Petitioner,

vs.

MISSOURI CAN COMPANY.

THE UNITED STATES,
Petitioner,

vs.

DETROIT CAN COMPANY.

BRIEF FOR PLAINTIFFS-RESPONDENTS.

The principal question involved in these cases is whether the net incomes of the plaintiffs, for the purposes of their Federal taxes for 1917, should be determined upon the basis prescribed in Section 12 of the Revenue Act, or upon the basis prescribed in the Regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

The plaintiffs contend that their incomes should be determined upon the basis prescribed in Section 12 of the Revenue Act because:

1. The Revenue Act of 1917 provided that, for the purposes of the Federal taxes, the net income of every corporation should be determined upon the basis prescribed in Section 12 of the Act, except in cases where a corporation kept its accounts and made its return upon some other basis which clearly reflected its income and complied with the Regulations made by the Commissioner with the approval of the Secretary of the Treasury.

2. The plaintiffs did not keep their accounts or make their returns for 1917 upon a basis which clearly reflected their incomes and complied with the Regulations made by the Commissioner with the approval of the Secretary of the Treasury.

The first of these propositions is established by the Revenue Act for 1917 and the decisions of this Court in *United States* v. *Anderson,* 269 U. S. 422, and *Reinecke* v. *Gardner,* 277 U. S. 239. The second of these propositions is established by the pleadings of the parties and the findings of the District Court. Both propositions were sustained by the District Court and the Circuit Court of Appeals.

The Commissioner ruled and determined that the basis upon which the plaintiffs kept their accounts and made their returns for 1917 did not clearly reflect their incomes or comply with the Regulations, but instead of redetermining their incomes upon the basis prescribed in Section 12 of the Revenue Act, he redetermined them upon the basis prescribed in the Regulations. The Commissioner used a basis which was different from the basis used by the plaintiffs and also different from the basis prescribed in Section 12 of the Revenue Act.

The net incomes of the plaintiffs upon the basis prescribed in Section 12 of the Revenue Act were less by several millions

of dollars than their incomes as returned by them, and their incomes as so returned were less by several millions of dollars than their incomes upon the basis prescribed in the Regulations.

The taxes could not be computed upon the basis used by the plaintiffs because that basis did not clearly reflect their incomes and comply with the Regulations.

The taxes could not be computed upon the basis prescribed in the Regulations because the plaintiffs did not keep their accounts or make their returns upon that basis.

The only basis upon which the taxes could be computed was the basis prescribed in Section 12 of the Revenue Act.

The District Court and the Circuit Court of Appeals held that the plaintiffs were entitled to recover the amounts of the taxes which they had paid in excess of the amounts which were payable upon the basis prescribed in Section 12 of the Revenue Act (20 Fed. 2nd 970; 31 Fed. 2nd 730).

These suits were brought against the United States under Paragraph 20 of Section 24 of the Judicial Code, as amended by the Revenue Acts of 1921 and 1925, because the Collector of Internal Revenue to whom the taxes were paid was not in office at the time of the commencement of the suits. They were tried by the District Court without a jury.

The petitions of the plaintiffs were filed and served on January 22, 1926 (R. pp. 1, 14, 97, 101, 115, 119), and the answers of the defendant were filed by the United States Attorney on April 28, 1926 (R. pp. 15, 102, 120). The answers admitted most of the allegations of the petitions. The plaintiffs introduced evidence at the trial to establish the allegations which were denied by the answers and the defendant offered no evidence to controvert that introduced by the plaintiffs. The Court handed down a memorandum decision (R. pp. 78-81) and also made special findings of fact and conclusions of law (R. pp. 86-90, 106-9, 125-9). He found all the facts which were admitted by the pleadings and also additional facts which were established by the undisputed evidence.

Statement of the Case.

The facts which are established by the pleadings and the findings, are substantially as follows:

The plaintiffs are corporations organized under the laws of New Jersey engaged in the business of manufacturing and selling cans and other containers and having their principal business offices in the City of New York (petitions, pp. 1-2, 97, 115, answers, pp. 15, 102, 120).

Prior to March 1921 William H. Edwards was the Collector of Internal Revenue of the United States for the Second District of New York, the district in which the plaintiffs had their principal places of business. Edwards was not in office as such Collector at the time of the commencement of these suits, but since March 1921 Frank K. Bowers was the Collector of Internal Revenue for the Second District of New York (petitions, pp. 2, 97, 115, answers, pp. 15, 102, 120).

The plaintiffs and their domestic affiliated corporations *kept their accounts* during 1917 *upon the basis of* accruing their receipts and disbursements, *valuing the normal stocks of tin plate carried in their inventories at a constant figure regardless of changes in the cost or market value of tin plate,* and valuing the other materials carried in their inventories at cost or market value, whichever was lower, with the presumption that the materials in the inventory were those last purchased (findings, pp. 86, 107, 125-6, evidence, pp. 32-3).

The plaintiffs and their domestic affiliated corporations *determined their incomes and made their Federal income and excess profits tax returns for 1917 upon the basis upon which their accounts were kept.* Said returns were filed in March, 1918 with Edwards, the Collector of Internal Revenue for the Second District of New York. The amount of the net income of the American Can Company *as so determined and returned* was $16,927,404.35 (including $60,010.50 as dividends upon the stock of other domestic corporations). The amount of

the net income of the Missouri Can Company *as so determined and returned* was $253,559.18. The amount of the net income of the Detroit Can Company *as so determined and returned* was $104,786.64. The amount of the consolidated net income of the plaintiffs and their domestic affiliated corporations *as so determined and returned* was $17,994,400.46 (including $60,010.50 as dividends upon the stock of other domestic corporations) (findings, pp. 86, 107, 126, evidence, pp. 35, 59 [104, 106, 112, 121]).

On or about June 14, 1918 the American Can Company paid and Edwards collected $3,266,499.86 as and for the income taxes for 1917 payable by the American Can Company and the excess profits tax for 1917 payable by the plaintiffs and their domestic affiliated corporations, the Missouri Can Company paid and Edwards collected $15,213.54 as and for the income taxes for 1917 payable by the Missouri Can Company, and the Detroit Can Company paid and Edwards collected $6,287.19 as and for the income taxes for 1917 payable by the Detroit Can Company, in accordance with the returns filed by them respectively. The total amount of the excess profits tax was allocated to and paid by the American Can Company as the parent corporation (findings, pp. 86, 107, 126, evidence, pp. 34, 59 [100-2]).

After June 14, 1918 and prior to September 21, 1920 the Commissioner of Internal Revenue made assessments against the American Can Company for additional income and excess profits taxes for 1917, aggregating $1,953,480.79. The American Can Company paid and Edwards collected $520,762.54 on or about November 22, 1919 and $1,432,718.25 on or about September 21, 1920 as and for such additional taxes (findings, p. 86, petition, pp. 2-3, answer, p. 15).

Thereafter the *Commissioner of Internal Revenue objected to the basis upon which the plaintiffs and their domestic affiliated corporations had valued their inventories of tin plate and determined their net incomes for 1917, and revalued their inventories of tin plate and redetermined their net incomes upon a different basis* and made assessments for additional income and excess profits taxes for 1917 aggregat-

ing $3,397,791.46 (petitions, pp. 3-4, 98, 116-7, answers, pp. 15, 102, 120).

Thereafter the plaintiffs filed with Bowers, as Collector of Internal Revenue, claims for the abatement of said assessments aggregating $3,397,791.46 and also claims for the refund of portions of the taxes which they had paid on June 14, 1918, November 22, 1919 and September 21, 1920. On and after January 26, 1924 the Commissioner disallowed and rejected said claims for abatement and said claims for refund and thereafter the plaintiffs paid to Bowers, as Collector of Internal Revenue, the amounts of the assessments involved in said claims for abatement, with interest, and brought actions against said Bowers in the District Court of the United States for the Southern District of New York to recover back the amounts so paid. Said actions are still pending undetermined (petitions, pp. 4, 98-9, 117, answers, pp. 15, 102, 120).

The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, made regulations which provided that all materials carried in inventories should be valued on the basis of (*a*) *cost, or* (*b*) *cost or market value, whichever was lower,* with the presumption that the materials in the inventory were those last purchased. *The basis upon which the plaintiffs and their domestic affiliated corporations kept their accounts and made their returns for 1917 was not in accordance with said regulations* (petitions, pp. 5, 100, 118, answers, pp. 15, 102, 120). *The Commissioner ruled and determined that the basis upon which the plaintiffs and their domestic affiliated corporations valued their inventories of tin plate and determined their net incomes for 1917 did not clearly reflect their incomes and was not authorized or permitted by the Revenue Act of 1917 or the regulations made thereunder, that their incomes for 1917 should not be determined upon the basis upon which they kept their accounts and made their returns and that their income and excess profits taxes for 1917 should not be computed upon their incomes as returned. The Commissioner ruled and determined that the basis upon which the plaintiffs and their domestic affiliated*

corporations kept their accounts and made their returns for 1917 did not clearly reflect their incomes (petitions, pp. 5, 100, 118-9, answers, pp. 15, 102, 120, findings, pp. 87, 108, 126).

The net income of the American Can Company for 1917, determined upon the basis and in the manner provided in Section 12 of the Revenue Act of 1917, was $12,754,886.02 ($60,010.50 thereof being dividends upon the stock of other domestic corporations). The net income of the Missouri Can Company for 1917, determined upon such basis was $124,164.87. The net income of the Detroit Can Company for 1917, determined upon such basis was $6,556.48. The consolidated net income of the American Can Company and its domestic affiliated corporations for 1917, determined upon such basis was $13,231,054.52 ($60,010.50 thereof being dividends upon the stock of other domestic corporations) (findings, pp. 87-90, 108, 126-7, evidence, pp. 35-9, 43-6, 59-64, 66-7).

The total amount of the Federal income taxes for 1917 payable by the American Can Company upon $12,754,886.02 of net income ($60,010.50 thereof being dividends upon the stock of other domestic corporations) and of the Federal excess profits tax for 1917 payable by the American Can Company and its domestic affiliated corporations upon $13,231,054.52 of consolidated net income ($60,010.50 thereof being dividends upon the stock of other domestic corporations) was $2,514,478.94 (findings, p. 90, evidence, pp. 46, 67).

The amount of the Federal income taxes for 1917 payable by the Missouri Can Company upon $124,164.87 of net income was $7,449.87 (findings, p. 108, evidence, pp. 40, 66).

The amount of the Federal income taxes for 1917 payable by the Detroit Can Company upon $6,556.48 of net income was $393.39 (findings, p. 126, evidence, pp. 40, 66).

No part of the amounts which the plaintiffs, or any of them, paid, or which Edwards collected, as and for Federal taxes for 1917 has been refunded or repaid or credited against any income, war profits or excess profits tax or instalment

thereof due or payable by the plaintiffs, or any of them (findings, pp. 90, 109, 126-7, evidence, pp. 40-1).

The conclusions of law found by the District Court were that the plaintiffs had paid and that Edwards, as Collector of Internal Revenue, had collected from the plaintiffs, $2,705,501.71 in the case of the American Can Company, $7,763.65 in the case of the Missouri Can Company, and $5,893.80 in the case of the Detroit Can Company, in excess of the amounts which were legally payable and collectible as and for Federal income and excess profits taxes for 1917, that said amounts were assessed and collected erroneously, illegally, wrongfully and without authority and that the plaintiffs were entitled to judgments for said amounts with interest at the rate of 6% per annum from the dates of payment (pp. 90, 109, 127).

The defendant refers to the evidence which shows how the plaintiffs handled on their books the matter of valuing their normal stocks of tin plate at a constant figure (R. pp. 48-9), but this evidence tends merely to confirm the evidence previously given with respect to the basis upon which the plaintiffs kept their accounts (R. pp. 32-3). The purpose and effect of the bookkeeping entries which the plaintiffs made in January 1917 was to carry their normal stocks of tin plate at a constant figure.

It may be noted here that these bookkeeping entries were made three months before the United States declared war upon Germany (April 7, 1917), and eight months before the Revenue Act of 1917 was passed (October 3, 1917). They were made at a time when the income taxes amounted to only two per cent of the net income. Nobody had any reason to expect that the rate of the income taxes would be materially increased and the matter of income taxation had not become a matter of any great practical importance to business corporations.

It could not be claimed that the plaintiffs were seeking to avoid the payment of income taxes and it is obvious that their only purpose was to meet the violent fluctuations in

prices which had been caused by the European War. The plaintiffs acted in entire good faith and upon sound business judgment, which the Courts will not question and which in fact the defendant has never questioned (see opening statements of counsel, R. pp. 25-30).

In any case the undoubted fact is that the plaintiffs made the basis of valuing their normal stocks of tin plate at a constant figure an integral and fundamental part of their system of accounting, the system which they actually employed in their business, upon the results of which profits or losses were determined, dividends were paid, reports to the stockholders were made and the continuance of the management was decided upon. That their action was prudent and wise from a business point of view cannot be questioned, even though the basis which they used for their own business purposes could not be used for income tax purposes.

That the Commissioner actually rejected the basis used by the plaintiffs is shown by the fact that he revalued the inventories and redetermined the incomes upon a different basis and that he actually made rulings and determinations to the effect that the basis used by the plaintiffs did not clearly reflect their incomes or comply with the Regulations and that such basis could not be used for income tax purposes.

We submit that the questions presented in these cases are not stated correctly on pages 2 and 3 of the defendant's brief.

The grounds for the claims for refund which the plaintiffs filed are not stated correctly on pages 6 to 7 of the defendant's brief (R. pp. 4, 15, 99, 102, 117, 120).

Questions Open to Review.

The question whether the rulings of the District Court upon the defendant's motion for judgment and requests for findings of fact are reviewable in this Court is not of much practical importance because there was no error in any such rulings. The findings of fact are fully supported by the evidence and in exact accordance with the evidence. The facts which the defendant requested the Court to find and which the Court did not find were either not supported by the evidence or wholly immaterial or adequately covered by the facts which were found.

It is well settled that in actions brought under the Tucker Act, now Section 24, paragraph 20 of the Judicial Code, the only question that can be reviewed by an Appellate Court is the question whether the facts found are sufficient to support the judgment. The Act requires the Court to make special findings of fact and precludes the Court from making a general finding (24 Stat. 505*c*, 359, Sec. 7. Annotated Code Sec. 764). The findings of fact made by the Court are conclusive and the question whether they are supported by the evidence is not reviewable.

Chase v. *United States*, 155 U. S. 489;
United States v. *Buffalo Pitts Co.*, 234 U. S. 228.

The only apparent exception is in cases where the findings of fact purport to include a statement of all the evidence upon which the finding of some ultimate fact is based. In such cases the findings of fact present on their face the question whether the ultimate fact is supported by any evidence. The cases at bar are not exceptions to the general rule above stated.

United States v. *Clark*, 96 U. S. 37, 40;
Stone v. *United States*, 164 U. S. 380;
Collier v. *United States*, 173 U. S. 79.

The rule may be different in other actions brought in the District Court where the parties waive a jury by stipulation.

In such a case the Court may make either special findings or a general finding. The case of *Maryland Casualty Company* v. *Jones,* 279 U. S. 792, was a case of this character.

It is clear in any case that the rulings in question cannot be reviewed unless they were made in the progress of the trial of the cause and are duly presented by a bill of exceptions (R. S. Sec. 700). The docket entries show that the defendant's requests for findings of fact and motions for judgment were filed on June 11, 1927, after the Court had rendered a memorandum decision which was filed on May 31, 1927, that the first order extending the term was filed on September 17, 1927, and the bill of exceptions was filed on November 9, 1927 (R. pp. 1, 96, 114).

Rule 6 of the District Court provides that the terms of the Court at Trenton commence on the third Tuesday in January and the second Tuesday in September. The cases at bar were tried at Trenton. The second Tuesday in September, 1927, was September 13th. It thus appears that the order extending the term was not filed until after the expiration of the term.

It cannot be said that the rulings in question were made in the progress of the trial of the cause, and in any case it is obvious that they are not duly presented by a bill of exceptions.

Muller v. *Ehlers,* 91 U. S. 249;
United States v. *Jones,* 149 U. S. 262;
Michigan Insurance Bank v. *Eldred,* 143 U. S. 293;
O'Connell v. *United States,* 253 U. S. 142;
Exporters v. *Butterworth-Judson Co.,* 258 U. S. 365.

The only rulings which the District Court made in the progress of the trial of the cause were with respect to the admission or exclusion of evidence. The defendant, however, does not rely upon any of these rulings or claim that any one of them was reversible error. As a matter of fact they did not relate to the competency of the evidence or the method of proof. None of these rulings, of course, are reviewable unless they were excepted to at the time and are duly presented by a bill of exceptions.

SUMMARY OF ARGUMENT.

We will argue:

1. The Revenue Act of 1917 provided that the income of every corporation should be determined upon the basis prescribed in Section 12 of the Act, except in cases where a corporation kept its accounts and made its return upon some other basis which clearly reflected its income and complied with the Regulations made by the Commissioner with the approval of the Secretary of the Treasury.

2. The plaintiffs did not keep their accounts or make their returns for 1917 upon a basis which clearly reflected their incomes and complied with the Regulations made by the Commissioner with the approval of the Secretary of the Treasury.

3. The findings of fact established the net incomes of the plaintiffs upon the basis prescribed in Section 12 of the Revenue Act and are fully supported by the evidence.

4. The plaintiffs are entitled to judgments for the amounts of the taxes paid in excess of the amounts payable upon the cash basis, with interest at the rate of six per cent per annum from the dates of payment to a date preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner of Internal Revenue.

POINT I.

The Revenue Act of 1917 provided that the income of every corporation should be determined upon the basis prescribed in Section 12 of the Act, except in cases where a corporation kept its accounts and made its return upon some other basis which clearly reflected its income and complied with the regulations made by the Commissioner with the approval of the Secretary of the Treasury.

The Acts of Congress which imposed and determined the amounts of the Federal income and excess profits taxes for 1917 were the Revenue Act approved September 8, 1916 (39 Stat. 756, c. 463), and the Revenue Act approved October 3, 1917 (40 Stat. 300, c. 63). These two Acts, taken together, constitute the Revenue Act of 1917. The Act of October 3, 1917, continued some of the provisions of the Act of September 8, 1916, amended some of its provisions and added some new provisions. The Revenue Acts of 1909, 1913 and 1916 imposed only taxes based upon the amount of the income. The Act of 1917 increased the rates of the income tax and added an excess profits tax based upon the amount of the invested capital and the amount of the income.

There is no doubt that the Revenue Act of 1917 prescribes the basis of actual receipts and disbursements, or the "cash" basis, as the primary basis for determining the amount of the income subject to the income and excess profits taxes. This basis is prescribed and defined in the Act with respect to both individuals and corporations. No other basis for determining income is prescribed or defined in the Act.

The only provisions of the Revenue Act of 1917 which authorize the computation of taxes upon any amounts other than the incomes determined on the cash basis, are Sections

8(*g*) and 13(*d*). The language of these two sections is exactly the same, except that the former applies to individuals and the latter to corporations.

These sections, 8(*g*) and 13(*d*), appeared for the first time in the Revenue Act of 1916. The Revenue Acts of 1909 and 1913 prescribed the cash basis for determining the amount of the income and did not authorize or permit taxpayers to make their returns upon any other basis.

The purpose of these new sections was to enable taxpayers who kept books upon bases other than the cash basis to make returns upon the basis of their books in cases where that basis clearly reflected the income, and to relieve such taxpayers from the burden of redetermining their incomes upon the cash basis. Their purpose was to grant a privilege to the taxpayers rather than to confer additional powers upon the Commissioner. These sections did not *require* any taxpayer to do anything.

Section 10 of Title 1 of the Revenue Act of 1917 imposes an income tax "upon the total net income *received* * * * by every corporation".

Section 201 of Title II of the Revenue Act of 1917 imposes an excess profits tax upon the income of every corporation, and Section 206 of the same Title provides that "for the purposes of this Title the net income of a corporation shall be *ascertained* and *returned* * * * for the taxable year upon the same basis and in the same manner as provided in Title I" of the Revenue Act of 1917.

Section 12 of Title I of the Revenue Act of 1917, so far as is material, reads as follows:

> "Section 12(*a*). In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from *the gross amount of its income received within the year* from all sources—
>
> First. All the ordinary and necessary expenses *paid within the year* in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the con-

tinued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

Second. All losses *actually sustained and charged off within the year* and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; * * *

Third. The amount of interest *paid within the year* on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of (*a*) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (*b*) one-half of its interest-bearing indebtedness then outstanding. * * *

Fourth. Taxes *paid within the year* imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits."

There is no doubt that the basis for determining the net income which is prescribed in Section 12 is the basis of actual receipts and disbursements, or the "cash" basis.

Section 13(*a*) of Title I provides that "the tax shall be computed upon the net income, *as thus ascertained,* received within each preceding calendar year", etc., obviously referring to the basis for ascertaining net income which is prescribed in Section 12.

Section 13(*b*) of Title I provides that "every corporation * * * subject to the tax herein imposed shall, on or before the first day of March, * * * render a true and accurate return of its annual net income in the manner and form to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and

containing such facts, data and information as are appropriate and, in the opinion of the Commissioner, necessary to determine the correctness of the net income returned and to carry out the provisions of this title".

Section 13(*d*) of Title I reads as follows:

> "(*d*) A corporation, joint-stock company or association, or insurance company, keeping accounts *upon any* basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect *its* income, *may,* subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make *its* return *upon* the basis *upon* which *its* accounts are kept, *in which case,* the tax shall be computed upon *its* income *as so returned.*"

There is no doubt that the basis of actual receipts and disbursements referred to in Section 13(d) is the basis for determining the net income which is prescribed in Section 12.

Section 14(*a*) of Title I provides that "all assessments shall be made and the several corporations * * * shall be notified of the amounts for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the fifteenth day of June * * * except in cases of refusal or neglect to make a return and in cases of *erroneous,* false or fraudulent returns, in which cases the Commissioner of Internal Revenue *shall,* upon the discovery thereof, at any time within three years after said return is due, *make a return* upon information obtained as provided for in this title or by existing law; and the assessment made by the Commissioner of Internal Revenue *thereon* shall be paid by such corporation * * * immediately upon notification of the amount of such assessment; * * *"

Section 14(*b*) of Title I provides that "When the assessment shall be made, as provided in this title, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue".

Section 13, including all its subdivisions, appears in the

Revenue Act under the heading "Returns", and Section 14, including all its subdivisions, appears in the Revenue Act under the heading "Assessment and Administration". It cannot be presumed that provisions of this character are intended to impose a tax or to affect in any way the substantive provisions of the Act which do impose the tax.

Reinecke v. *Gardner*, 277 U. S. 239, 242-4.

Sections 13(*b*), 14(*a*) and 14(*b*) are purely administrative and they do not affect or qualify in any way the substantive provisions of the Act with respect to the determination of the income and the computation of the tax. These sections do not authorize the Commissioner to make an additional assessment or to make a "correction" of a return unless he makes a new return. The procedure clearly outlined in cases where no return is made or an erroneous return is made, is for the Commissioner to obtain the necessary information and make the return which the Revenue Act *required* the corporation to make, and to make an additional assessment "thereon". The "corrections" of returns to which reference is made in Section 14(*b*) include only the "corrections" which the Commissioner is authorized to make by making new returns.

It is clear beyond question that in making a return and determining the amount of the income to be stated therein, the Commissioner is bound to follow the substantive provisions of the Act with respect to the determination of the income. There are no provisions in the Act with respect to the determination of the income other than those to which we have already referred.

Section 13(*d*) qualifies Section 12 and Section 13(*a*) to the extent, and only to the extent, that it is inconsistent with them, and it withdraws from Section 12 and Section 13(*a*) those cases, and only those cases, which fall clearly within its terms. Section 12 and 13(*a*) state the general rule. Section 13(*d*) creates an exception. All cases which do not fall clearly within the terms of an exception are necessarily gov-

erned by the general rule, and all cases which do not fall clearly within the terms of Section 13(*d*) are necessarily governed by Section 12 and Section 13(*a*).

The only cases which fall within the terms of Section 13(*d*) are cases where a corporation keeps its accounts and makes its return upon a basis which clearly reflects its income and complies with the Regulations, made by the Commissioner, with the approval of the Secretary of the Treasury. In a case where a corporation does not so keep its accounts *and* make its return, Section 13(*d*) does not apply and the tax should be computed upon the cash basis prescribed in Section 12.

It is clear that Section 13(*d*) did not *authorize* any corporation to make a return upon any basis other than the cash basis, unless it complied with the Regulations made by the Commissioner, with the approval of the Secretary of the Treasury, and clear that one function of such Regulations was to prescribe rules for determining whether the basis used by any particular corporation was one which clearly reflected its income and one which the corporation had the right to use for income tax purposes under Section 13(*d*). In every case where a corporation made a return upon a basis other than the cash basis it was the duty of the Commissioner to determine whether the basis used by the corporation was one which clearly reflected its income, and obviously the intention of Congress that he should do so under general rules so that all taxpayers would have fair and equal treatment.

The Regulations which the Commissioner made, with the approval of the Secretary of the Treasury, were conclusive upon the question whether any particular basis other than the cash basis was one which clearly reflected the income and could be used for income tax purposes under Section 13(*d*).

It is equally clear that Section 13(*d*) did not *require* any corporation to make a return upon any basis other than the cash basis. Section 13(*d*) merely *authorized* a corporation to make a return upon a basis other than the cash basis, if

it was able to comply, and did comply, with that Section and with the Regulations. Section 13(*d*) did not *require* any corporation to do anything.

There is no reason for placing any forced or unnatural interpretation upon the language of Section 13(*d*), and if there were any doubt as to its meaning the doubt should be resolved in favor of the plaintiffs rather than the defendant.

In the first place Section 13(*d*) appears in a Revenue Act and it is well settled that all provisions of a Revenue Act should be construed strictly against the Government and in favor of the taxpayer; in the second place Section 13(*d*) is an exception which qualifies Sections 12 and 13(*a*), and it is well settled that an exception in a statute should be construed strictly so as not to take out of the general clause any case which does not fall clearly within the terms of the exception; and in the third place Section 13(*d*) is a new provision which had no counterpart in the Revenue Acts before 1916 and it is well settled that a new provision of law should be construed strictly so as not to change the existing law any more than is clearly indicated by the terms of the new provision.

The authorities establish the general rule that the Commissioner has no power to compute or assess taxes unless it affirmatively conferred by an Act of Congress by clear and unequivocal language. Revenue Acts are not to be extended, by implication, beyond the clear import of the language used. In case of doubt they are to be construed most strongly against the Government and in favor of the taxpayer. An omission in a Revenue Act cannot be supplied by the courts or the Commissioner.

Gould v. *Gould*, 245 U. S. 151;
United States v. *Field*, 255 U. S. 257;
Smietanka v. *First Trust & Savings Bank*, 257 U. S. 602;
United States v. *Merriam*, 263 U. S. 179.
Iselin v. *United States*, 270 U. S. 245;
Reinecke v. *Gardner*, 277 U. S. 239, 244.

The authorities also establish "the general rule of law which has always prevailed, and become consecrated almost as a maxim in the interpretation of statutes, that where the enacting clause is general in its language and objects, and a proviso is afterwards introduced, that proviso is construed strictly, and takes no case out of the enacting clause which does not fall fairly within its terms. In short, a proviso carves special exceptions only out of the enacting clause; and those who set up any such exception, must establish it as being within the words as well as within the reason thereof."

United States v. *Dickson,* 15 Peters 141, p. 165;
Ryan v. *Carter,* 93 U. S. 78, p. 83;
Schlemmer v. *Buffalo, Rochester, etc., Railway,* 205 U. S. 1.

The authorities also establish the general rule that when Congress adopts a new provision of law, it is not presumed that Congress intends to change the existing law any further than is clearly indicated by the terms of the new provision. The cases refer frequently to the familiar rule that "in construing altered revenue laws, the whole system must be regarded in each alteration, and no disturbance allowed of existing legislative rules of general application beyond the clear intention of Congress".

Steamship Company v. *Joliffe,* 2 Wallace 450;
Shaw v. *Railroad Co.,* 101 U. S. 557, 565;
Bear Lake Irrigation Company v. *Garland,* 164 U. S. 1;
Johnson v. *Southern Pacific Co.,* 196 U. S. 1, 17;
Maul v. *U. S.,* 274 U. S. 501;
Quinn v. *Bancroft-Jones Corp.,* 18 Fed. 2nd 727, 728 (C. C. A., 2nd Cir. 1927);
Gillam v. *U. S.,* 27 Fed. 2nd 296 (C. C. A. 4th Circ. 1928).

The authorities also establish the general rule that an act of Congress should be interpreted in accordance with the

language used by Congress, and that such language should be interpreted in accordance with its natural and ordinary meaning, Congress being presumed to know the meaning of words and rules of grammar. "No mere omission, no mere failure to provide for contingencies, which it may seem wise to have been specifically provided for, justify any judicial addition to the language of the statute." Ordinarily there is no excuse for departing from a literal interpretation of the language used by Congress.

United States v. *Goldenberg,* 168 U. S. 95;
Ozawa v. *United States,* 260 U. S. 178;
Lewellyn v. *Harbison,* 31 Fed. 2nd 740 (C. C. A. 3rd Cir., 1929);
Van Camp & Sons Co. v. *American Can Co.,* 278 U. S. 245.

In the case last cited, the Supreme Court said at page 147:

> "Decisions of this court, where the letter of the statute was not deemed controlling and the legislative intent was determined by a consideration of circumstances apart from the plain language used, are of rare occurrence and exceptional character, and deal with provisions which, literally applied, offend the moral sense, involve injustice, oppression or absurdity (*United States* v. *Goldenberg,* 168 U. S. 95, 103, 42 L. ed. 394, 398, 18 Sup. Ct. Rep. 3), or lead to an unreasonable result, plainly at variance with the policy of the statute as a whole (*Ozawa* v. *United States,* 260 U. S. 178, 194, 67 L. ed. 199, 207, 43 Sup. Ct. Rep. 65)."

In *United States* v. *Anderson,* 269 U. S. 422, this Court had occasion to consider Sections 10, 12(*a*), 13(*a*) and 13(*d*) in connection with adjustments which the Commissioner made with respect to the taxes for 1916 and 1917, resulting in a net increase of the tax for 1917. The corporations involved in this case kept their accounts on the basis of accruing all their receipts and disbursements and they accrued on their books in 1916 their munitions taxes for 1916, which were payable and paid in 1917. They made their

returns for 1916 and 1917 on the basis of their books except that they deducted their munitions taxes from their incomes for 1917 instead of their incomes for 1916. The Commissioner ruled that their munitions taxes should be deducted from their incomes for 1916 instead of their incomes for 1917, and this Court sustained the adjustment of the taxes made in accordance with this ruling.

The corporations admitted that the basis on which their accounts were kept clearly reflected their incomes and that they were not able to make their returns on the basis of actual receipts and disbursements and they made no effort to prove the amounts of their incomes on the basis of actual receipts and disbursements.

The Government contended that the corporations had elected to make their returns on the accrual basis and that accordingly the Commissioner had the right to redetermine their incomes on the accrual basis. The corporations contended that they had the right under the Revenue Act to deduct their taxes in the year in which they were paid, and that in any case taxes did not accrue until they were due and payable. This Court did not sustain any one of these contentions but, on the contrary, held that as the corporations were not able to make their returns on the basis of actual receipts and disbursements, and as their accounts were kept on a basis which clearly reflected their incomes and complied with the Regulations, they were required to make their returns on the basis of their own books of account, and that the adjustments made by the Commissioner merely had the effect of making their returns accord with their own books of account.

Mr. Justice Stone, in writing the opinion of the Court, said at pages 436 *et seq.* (Italics ours):

> "While § 12(*a*) taken by itself would appear to require the income tax return to be made on the basis of actual receipts and disbursements, it is to be read with § 13(*d*) which we have quoted and which *obviously limits in some respects the operation of* § 12(*a*) by providing in substance that a corporation keeping its books

on a basis other than receipts and disbursements, *may make its return on that basis provided it is one which reflects income.*

"Standing by themselves and taken at their face value, these sections would seem to *require* the taxpayer to make its return on the basis of receipts and disbursements or, in the alternative, *on the basis of its own books of account if they reflect true income,* under such regulations as the Commissioner may make, and indeed to *require* the latter alternative *if the taxpayer is unable to make a return except on that basis.*

"So interpreting the statute, the Commissioner, with the approval of the Secretary of the Treasury, on January 8, 1917, before appellee made its income tax return for 1916, promulgated Treasury Decision 2433 which provides in part that under § 13(*d*) it 'will be permissible for corporations which accrue on their books monthly or at other stated periods amounts sufficient to meet fixed annual or other charges to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.' It also provided in substance that when the taxpayer, following a consistent accounting practice sets up reserves to meet liabilities, the 'amount of which or date of maturity' is not definitely determinable, such reserve may be deducted from gross income. The decision also laid down a procedure for readjusting such reserves when the amount actually required for that purpose was definitely ascertained, and *provided that if returns upon this basis of 'accrual or reserve' did not reflect true net income, the taxpayer would not be permitted to make its return on any other basis than that of 'actual receipts and disbursements'.*

"We think that the statute was correctly interpreted by the Commissioner and that his decision referred to was consistent with its purpose and intent.

At page 439:

"But, in the Act of 1916, Congress added § 13(*d*), *which did not have its counterpart in earlier legislation.*

This section went further than any previous regulation by *authorizing* the tax return to be made on the basis on which the taxpayer's books were kept, *provided only that the basis was one reflecting income and the return complied with regulations made by the Commissioner.*

"Treasury Decision 2433, to which reference has been made, was in harmony with this view of § 13(*d*). It recognized the right of the corporation to deduct all accruals and reserves, without distinction, *made on its books* to meet liabilities, provided the *return* included income accrued and, *as made,* reflected true net income. If the *return* failed so to reflect income, the regulation reserved the right of the Commissioner *to require the return to be made on the basis of receipts and disbursements.*"

At page 440:

"The taxpayer *being unable to make its return on a strict receipts and disbursements basis, and not having attempted to do so,* could not have complied with § 13(*d*) and Treasury Decision 2433 by deducting either accruals of interest or expenses alone without the other, or without deducting other *reserves made on its books* to meet liabilities such as the munitions tax, incurred in the process of creating income."

At page 443:

"Since the suit was one to recover a tax erroneously exacted, *the burden was on the petitioners,* appellees here, *to prove the facts establishing the invalidity of the tax.* But the findings fail to show affirmatively that the books were kept or the return made on the basis of receipts and disbursements. Indeed, the facts found, to which we have referred, show that the books were kept on the basis of accruals and reserves to meet liabilities incurred. It does not appear that there was any expense or liability of the taxpayer incurred by its operations during the year which was not *accrued on its books.* Its return was made on that basis, but omitted munitions taxes *accrued on its books during the year* for which the return was made."

In *Reinecke* v. *Gardner,* 277 U. S. 239, it was held that the Revenue Act of 1917 did not require a trustee in bankruptcy

to pay the excess profits tax, although it did require him to pay the income tax, and it was further held that the question whether the taxpayer should deduct interest accrued in 1916 but paid in 1917 from his gross income for 1916 or his gross income for 1917 could not be answered, because the record did not show whether the books of the taxpayer "as kept" reflected his income, and did not show on what basis his return was made. The record did show that the taxpayer was carrying on the business of a coal mining corporation and keeping his books upon an accrual basis. The Court held in substance that the taxpayer was required to make his return upon the cash basis, unless he kept his books on an accrual basis which accurately reflected his income, and actually made his return on that basis. The Court said at pages 244-5 (Italics ours):

> "The applicable section, 13(*d*) of the Act of 1916, directs that if the taxpayer keeps his books on any basis other than that of actual receipts and disbursements, and the return is made on the basis adopted, the tax shall be computed on that basis *unless the books clearly do not reflect the taxpayer's true income.* In *United States* v. *Anderson,* 269 U. S. 422, it was pointed out that under the Act of 1916 and applicable treasury regulations, *the taxpayer must make all deductions from gross income as of the year when the payments were made unless he keeps his books on an accrual basis which accurately reflects his income, and actually made his return on that basis.* See *United States* v. *Mitchell,* 271 U. S. 9; *American National Co.* v. *United States,* 274 U. S. 99. The present certificate fails to state whether the books of the trustee *as kept* reflected his income or whether his return was made on the accrual basis or on the basis of actual receipts and disbursements. Under Jud. Code, § 239 the facts pertinent to the question asked must be certified. When they are omitted from the certificate the question need not be answered. *Dilton* v. *Strathearn S. S. Co.,* 248 U. S. 182."

These two decisions sustain the proposition that if the basis upon which the accounts are kept, or the return is made, does not clearly reflect the income or does not comply with

the Regulations, the tax should be computed upon the cash basis.

They also sustain the proposition that if the books "as kept," or the return "as made," do not clearly reflect the income or do not comply with the Regulations, the tax should be computed upon the cash basis.

In the *Anderson* case the taxpayers kept their accounts upon a basis which clearly reflected their incomes and complied with the Regulations, and they were not able to make their returns upon the cash basis. In that case the only basis which could be used was the book basis.

In the cases at bar the plaintiffs did not keep their accounts upon a basis which clearly reflected their incomes and complied with the Regulations, and they were able to make their returns upon the cash basis. In these cases the only basis which could be used is the cash basis.

There is no reason why the taxes of the plaintiffs should not be computed in strict accordance with the Revenue Act.

The defendant contends in substance that if a corporation used a basis or made a return which did not clearly reflect the income or did not comply with the Regulations, the Commissioner had the power to redetermine the income and compute the tax upon the basis prescribed in the Regulations.

This contention is refuted not only by the language of the Revenue Act of 1917 and the two decisions last above mentioned, but also by the changes which Congress made in the Revenue Acts for 1918 and subsequent years with respect to the determination of the income. The provisions of these Acts with respect to the determination of the income are entirely different from those of the prior Acts.

Section 233(*a*) of the Revenue Act of 1918 provides that in the case of a corporation the term "gross income" means the gross income as defined in Section 213, with certain exceptions applicable to insurance companies. Section 213 provides that the term "gross income" includes "gains, profits and income derived from * * * trades, businesses, commerce, or sales, or dealings in property," etc. and that "The

amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, *unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period".*

Section 234(*a*) provides that in computing the net income of a corporation there shall be allowed as deductions "(1) All the ordinary and necessary expenses *paid or incurred* during the taxable year in carrying on any trade or business," etc., "(2) all interest *paid or accrued* within the taxable year on its indebtedness," etc., "(3) taxes *paid or accrued* within the taxable year," etc. and certain other amounts representing losses, depreciation, amortization, etc.

The last paragraph of Section 200 provides:

> "The term 'paid,' for the purposes of the deductions and credits under this title, means 'paid or accrued' or 'paid or incurred,' and the terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is compiled under section 212."

Subdivision (*b*) of Section 212, an entirely new and most important provision, is as follows:

> "(*b*) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) *in accordance with the method of accounting regularly employed in keeping the books of such taxpayer;* but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made *upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income."*

The Revenue Acts prior to 1918 made no reference to inventories. The Revenue Act of 1918, however, provides in Section 203:

> "That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to

determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

The later Revenue Acts contained substantially the same provisions with respect to the determination of the income and the powers of the Commissioner in connection therewith.

Revenue Act of 1921, approved Nov. 23, 1921, 42 Stat. 227 c. 136, Secs. 233(*a*), 213, 234(*a*), 200(4), 212(*b*), 203.

Revenue Act of 1924, approved June 2, 1924, 43 Stat. 253 c. 234, Secs. 233(*a*) 213, 234(*a*), 200(*d*), 212(*b*), 205.

Revenue Act of 1926, approved Feb. 26, 1926, 44 Stat. 9 c. 27, Secs. 233(*a*), 213, 234(*a*), 200(*d*), 212(*b*), 205.

Revenue Act of 1928, approved May 29, 1928, 45 Stat. 791, c. 852, Secs. 21, 22(*a*), 23, 48(*c*), 41, 22(*c*).

The fact that the Revenue Acts for 1918 and subsequent years conferred upon the Commissioner the power to prescribe a basis for determining the income, and to redetermine the income on such basis, in cases where the basis used by a taxpayer did not clearly reflect his income, by provisions entirely different from any contained in the prior Acts, tends strongly to show that the Commissioner had no such power under the prior Acts.

U. S. v. *Field,* 255 U. S. 257;

Smietanka v. *First Trust & Savings Bank,* 257 U. S. 602;

Shwab v. *Doyle,* 258 U. S. 529 (1922).

POINT II.

The plaintiffs did not keep their accounts or make their returns for 1917 upon a basis which clearly reflected their incomes and complied with the Regulations made by the Commissioner with the approval of the Secretary of the Treasury.

The Regulations which the Commissioner issued under the Revenue Acts of 1916 and 1917, with the approval of the Secretary of the Treasury (Reg. 33 revsd.) included the following:

> "Art. 91. Manufacturing corporations.—Gross income for the purpose of returns of manufacturing companies shall consist of the total sales plus the inventory at the end of the year less the sum of the cost of goods or materials purchased during the year and the inventory at the beginning of the year. Instructions as to how inventories shall be taken will be included in special regulations to be furnished upon application to the Collector of Internal Revenue."

Special Regulations with respect to the valuation of inventories were issued by the Commissioner, with the approval of the Secretary of the Treasury, in the form of a letter to Collectors of Internal Revenue dated December 19, 1917 (T. D. 2609). They included the following:

> "Inventories of supplies, raw materials, work in process of production, and unsold merchandise, must be taken either (a) at cost, or (b) at cost or market price, whichever is lower."

It is obvious that these Regulations applied only to the matter of determining the income of a manufacturing corporation upon an accrual basis. They had no relation to the matter of determining the income upon the cash basis pre-

scribed in Section 12. Neither the "sales" made by a corporation, nor the "cost" of goods or materials purchased by a corporation, nor the "inventory" of a corporation at the beginning or the end of the year is an actual receipt or an actual disbursement. These factors are not mentioned in Section 12 and they can be used only in connection with an accrual basis of accounting for income. (See Point III, *infra.*)

The Regulations above mentioned are undoubtedly valid for the purpose of determining whether an accrual basis used by a manufacturing corporation was one which clearly reflected its income and one which the corporation had the right to use for income tax purposes under Section 13(*d*).

These Regulations establish conclusively that no manufacturing corporation could make a return under Section 13(*d*) unless it accrued its receipts and disbursements, and used inventories valued upon the basis of (a) cost, or (b) cost or market price, whichever was lower, reflecting in its income the difference between the inventory at the beginning of the year and the inventory at the end of the year. They establish conclusively for income tax purposes that no other basis would clearly reflect the income of such a corporation. This is conceded and asserted throughout the defendant's brief (pp. 20, 22, 27-8, 32-3).

The Commissioner did not issue any Regulations with respect to the valuation of inventories prior to December 19, 1917. The Regulations which he then issued precluded the use for income tax purposes of the basis upon which the plaintiffs had already kept their accounts during 1917 and made it impossible for the plaintiffs to make returns for 1917 under Section 13(*d*). No corporation had the right to make a return under that Section unless it kept its accounts upon a basis which clearly reflected its income and complied with the Regulations.

The purpose and effect of inventories when used in connection with an accrual basis of accounting for income is clearly shown in two rulings which the Commissioner issued in the latter part of 1919 (T. B. R. 48, 1 Cum. Bul. 47, T. B. R. 65, 1 Cum. Bul. 51). In these rulings the Advisory

Tax Board considered carefully the question whether certain bases for valuing inventories, other than the bases of (a) cost, and (b) cost or market price whichever is lower, were bases which clearly reflected the income and should be authorized by the Regulations for income tax purposes. These other bases included the basis used by the plaintiffs, which is sometimes called the "base stock" method. The Advisory Tax Board reached the conclusion that no one of these other bases would clearly reflect the income assignable to an annual accounting period, that no one of them was authorized, and no one of them should be authorized, by the Regulations for income tax purposes.

In T. B. R. 48 the Advisory Tax Board said:

> "Request has been made for advice as to whether the average cost method of taking inventories used by certain corporations is permissible under the act of September 8, 1916, or under the act of October 3, 1917. Briefly stated, the method in question is as follows:
>
> "Materials purchased during a month are added, both as to quantity and cost, to the quantity and cost balance brought forward from the previous month, and an average cost to the close of the month is computed by dividing the total quantity into the total money figures. This average is then applied to the quantity of materials used for manufacture during the month, and the amount so computed is credited to the material account. This process is a well-established custom, which has been adopted by the leading concerns of the trade.
>
> * * * * * *
>
> "Commercial practice sanctions the custom of an annual accounting for profits or losses, and the income tax laws have required such annual accounting. It must be admitted, however, that such a computation is not only difficult, but that a year is in many businesses a period too short to be satisfactory. * * * Whatever the difficulty and whatever the degree of accuracy in attaining it, the object to be kept in view is the ascertainment of the profits during the year which have been realized upon sales actually made, inasmuch as profits can arise only through the sale or exchange of property. * * * The

logical method of computation is, therefore, to apply against the total sales of the period the cost of the goods covered by such sales, and the difference between these two amounts represents gross profits. Precisely this is accomplished when inventories are taken upon the basis of cost.

"A loss, although seemingly the opposite of a profit, may, however, fall under a different rule. A loss may be occasioned by physical destruction or deterioration of property included in an inventory or it may be attributable to changes in styles or other causes affecting salability, or it may be occasioned by shrinkage in market value. Where such losses arise, even though not fully consummated by a sale of the goods, the fact should nevertheless be recognized, and when such goods are taken in an inventory they may, if the taxpayer so elects as a consistent policy, be valued at market instead of cost, where market is lower. This is true even in spite of the possibility that conditions may change, and at a date before a sale is made the goods may again be worth their original cost. * * * The rule of cost or market, whichever is lower, even though it may appear to lack in consistency, thus, nevertheless, rests upon solid ground, and its widespread adoption throughout the business world amply justified its adoption for tax purposes.

* * * In a business requiring goods to be carried for lengthy periods and where an average method of inventory valuation is used, this overstatement of profits will occur whenever the current market is declining, while on an advancing market the profits on the actual sales of the year will be understated. When the market is stable the average method will reflect with approximate accuracy the true profits, and in a business in which the turnover is rapid the effect of such a method upon the computation of annual income is small as compared with a business in which it is necessary to carry goods, such as raw materials, for long periods. * * * The computation of net income upon such a basis results in an assignment of income to a year, not upon the basis of the transactions of the year, but upon the basis of transactions part of which spread over more than a year. * * * An annual accounting period is a fundamental requirement of the Federal income-tax legislation, and every computation of taxable net income must

be made in conformity therewith. This the average cost inventory method failed to do, and its use can not be approved as meeting the statutory requirement."

In T. B. R. 65 the Advisory Tax Board said (Italics ours):

"The question is raised as to whether under the Revenue Acts of 1917 and 1918 the so-called 'base stock,' 'minimum,' or 'cushion,' hereinafter referred to as 'base stock,' method of taking inventories may be used.

"Section 203 of the Revenue Act of 1918 provides as follows:

"That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

"Article 1582 of Regulations 45 provides in part that:

"Inventories should be valued at (a) cost, or (b) cost or market, whichever is lower.

"*According to the base-stock method of taking inventories a manufacturer or dealer values at the same price year after year the minimum quantity of goods which he must have on hand at all times.*

* * * * * *

"Clearly the base-stock method of taking inventories is not within the terms of the regulations—that is, it is not such a basis as the Commissioner, with the approval of the Secretary, has prescribed. It remains to consider, however, whether such a method should be so prescribed 'as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.'

"The facts before the Advisory Tax Board do not warrant the conclusion that there has been any general adoption of the base-stock method of taking inventories as an 'accounting practice,' or that it has had any considerable recognition as the 'best' accounting practice.

On the contrary, it is certain that the method has not been widely adopted. * * * In particular, the fact that so few business concerns use the base-stock method is strongly suggestive of the truth that *it does not truly reflect the income.*

"That it is a truth appears as clearly upon analysis as upon an examination of trade practice. The present Federal income-tax system is based upon an annual accounting period. *The object of an inventory is to assign to an annual accounting period its profits and losses. The effect of the base-stock inventory method is to assign all profits and losses in respect of the minimum inventory to the year in which such inventory is liquidated.* This result is accomplished through ignoring sales and exchanges of individual items of the inventory and treating the minimum inventory as a unit. Each sale or exchange of property for other property having a market value is, however, in fact a realization of taxable profit or deductible loss in the year in which it occurs and *a method of accounting which disregards such realization does not truly reflect income.*

* * * * * *

"Where the base-stock method is used it is true, as was stated in Advisory Tax Board Recommendation 48 with respect to the average cost inventory method that 'in a business requiring goods to be carried for lengthy periods * * * *this overstatement of profits will occur whenever the current market is declining, while on an advancing market the profits on the actual sales of the year will be understated.'* The Advisory Tax Board, therefore, concludes that *the base-stock inventory method does not 'most clearly' reflect income.* For a more complete discussion of the subject of inventories see the Advisory Tax Board recommendation above referred to.

* * * * * *

"It is suggested in behalf of the taxpayer that if the base-stock method is not approved, some alternative method should be prescribed other than the valuation of inventories as required by the present regulations at cost or market, whichever is lower. One method proposed is that inventories be valued on a moving average basis over a period of five years, more or less. According to this method one-fifth, for example, of the inventory

would be deemed to be the goods most recently purchased, and the balance the goods on hand at the beginning of the year. Another method proposed is that the goods in the inventory be deemed to be the earliest rather than the latest purchases. *These methods are open to the same objections as is the base stock method. Inventories valued according to these methods would not as clearly reflect the income assignable to an accounting period as do inventories valued according to the present regulations.*

"Most of the reasoning above set forth with respect to the Revenue Act of 1918 applies to the Revenue Act of 1917. The Advisory Tax Board finds nothing in the earlier statute to warrant the use thereunder of methods of valuing inventories which can not be used under the later statute.

"The Advisory Tax Board is of opinion, therefore, that neither the base stock method of taking inventories nor the moving average method, nor a method based upon the presumption that goods in the inventory are the earliest purchases, is in conformity with the provisions of the Revenue Act of 1917 or of the Revenue Act of 1918, and recommends that no change be made in the present regulations with respect to the method of taking inventories."

These rulings show clearly, and indeed it is quite obvious as a matter of law, that (1) the word "basis" as used in Section 13(*d*) means a basis of accounting for, and determining the amount of, the net income of a corporation for a taxable year, (2) a basis which clearly reflects the income means a basis which measures accurately the amount of the true net income of a corporation for a taxable year, (3) the purpose of using inventories is to assign the net income of a corporation to separate accounting periods and determine the amount of the net income separately for each accounting period, (4) each one of the various different bases for valuing inventories affects differently the assignment of the net income to separate years and the determination of the amount of the net income for each year, and (5) an accrual basis of accounting does not clearly reflect the income

and comply with the Regulations unless it includes the use of inventories valued upon a basis which clearly reflects the income and complies with the Regulations.

The difference between one basis for valuing inventories and another basis for valuing them is similar in kind to the difference between the cash basis and any accrual basis. The difference in either case is with respect to the assignment of the net income to separate accounting periods and the time as of which the net income is deemed to be earned.

It is obvious that although the average cost method and the base stock method for valuing inventories cannot be used for income tax purposes, they are proper and desirable methods for business corporations to use. These methods reflect the true net income approximately over a period of years, and they tend to stabilize the income from year to year and lessen the effect thereon of fluctuations in prices. The life of a corporation is not limited to one year and it is proper for any corporation to so conduct its business as to preserve a reasonable equilibrium and stability over a period of years, particularly at a time of abnormal price conditions.

While the base stock method is not used so generally as the cost or market method, it is used by many business corporations, including such well known corporations as the American Smelting & Refining Company and the National Lead Company. It was used by the Chicago Frog & Switch Company whose case was decided by the Court of Claims June 3, 1929 (Unofficially reported in Federal Courts Volume of Corporation Trust Company's Tax Service C. L. 67108) and the Western Dry Goods Company whose case was decided by the District Court for the Western District of Washington July 3, 1929 (Unofficially reported in District Courts Volume of Corporation Trust Company's Tax Service, p. 8180). These cases are cited on page 25 of the defendant's brief.

The defendant's brief admits that the plaintiffs are entitled to have their taxes computed upon the cash basis and to recover any excess which they may have paid over the amounts legally payable upon that basis, if the basis upon

which they kept their accounts and made their returns did not clearly reflect their incomes (pp. 28-30), that the basis upon which the plaintiffs valued their inventories and determined their incomes, both in keeping their accounts and making their returns, did not clearly reflect their incomes and did not comply with the Regulations, and that the Commissioner revalued their inventories and redetermined their incomes upon a different basis, *i. e.,* the basis prescribed in the Regulations (pp. 5-6, 10, 20, 22, 26, 27, 28, 33).

The defendant argues however that the word "basis" as used in Section 13(*d*) does not mean a basis for determining the income of a corporation for a taxable year, that it has reference only to two fundamental systems of accounting generally known as "the cash basis" and "the accrual basis", that when Section 13(*d*) referred to "any basis other than that of actual receipts and disbursements", it referred to "an equally basic system of accounting", meaning "the accrual basis", that the matter of valuing inventories has no bearing upon the treatment of items of income and expenditures and nothing to do with the basis of accounting as that term is used in Section 13(*d*), that the plaintiffs kept their accounts and made their returns upon "the accrual basis", that the Commissioner had power to redetermine their incomes upon "the accrual basis" in accordance with the Regulations and that the changes made by the Commissioner corrected the errors in the returns "without disturbing the basic accrual system of accounting, so that it is entirely clear that the accrual system as corrected discloses respondents' true net income" (pp. 21-3, 26-28).

One obvious difficulty with this argument is that an accrual basis does not clearly reflect the income and comply with the Regulations unless it includes the use of inventories valued upon a basis which clearly reflects the income and complies with the Regulations.

The mere statement that the plaintiffs kept their accounts and made their returns upon the accrual basis does not show the basis upon which they valued their inventories, and con-

sequently does not show that they kept their accounts or made their returns upon a basis which clearly reflected their incomes and complied with the Regulations.

The defendant's argument ignores the fundamental requirement of Section 13(*d*) which was that no basis could be used for income tax purposes under that Section unless it clearly reflected the income and complied with the Regulations.

The word "basis" as used in Section 13(*d*) meant something which either did or did not clearly reflect the income, and either did or did not comply with the Regulations, and it must have meant something which was complete and specific enough to enable a person to determine whether it did or did not clearly reflect the income, and whether it did or did not comply with the Regulations.

It is true that there are no bases, other than the cash basis, except those which include the accrual of receipts and disbursements, but it does not follow that there is only one accrual basis. It is obvious that an accrual basis with inventories valued upon one basis is different from an accrual basis with inventories valued upon a different basis.

Section 13(*d*) did not refer to the accrual basis or even use the word "accrual". It did not provide that if a corporation kept its accounts and made its return upon "the accrual basis" the tax should be computed upon "the accrual basis". On the contrary, it referred to "*any* basis other than that of actual receipts and disbursements", authorized a corporation which kept its accounts upon *any* such basis to make its return upon *the* basis upon which *its* accounts were kept, if such basis clearly reflected its income, and provided that if a corporation kept its accounts and made its return upon such a basis, the tax should be computed upon *its* income *as so returned.* Section 13(*d*) clearly recognized that there was more than one basis other than that of actual receipts and disbursements, and consequently recognized that there was more than one form or kind of an accrual basis and that each different form or kind of an accrual basis was a different basis of accounting for income.

When Section 13(*d*) referred to the basis of actual receipts and disbursements, it referred to the basis or method for determining net income which is prescribed in Section 12, and when it referred to any basis other than that of actual receipts and disbursements, it must have referred to any basis or method for determining the net income other than that prescribed in Section 12.

Section 13(*d*) did not authorize the Commissioner to redetermine the income of a corporation upon the basis prescribed in the Regulations. It merely authorized him in certain cases to compute the tax upon the income "as so returned." These words cannot mean anything other than (*a*) the amount of the income stated in the return or (*b*) the amount of the income determined upon the basis upon which the corporation kept its accounts and made its return, *i. e.,* the basis upon which the corporation determined its income when it kept its accounts and made its return.

If a corporation kept its accounts and made its return upon an accrual basis with inventories, it is obvious that nobody could determine the income of the corporation upon the basis used by the corporation unless he knew and used the basis upon which the corporation valued its inventories.

The correct interpretation of Section 13(*d*) is clearly indicated by the language of this Court in *Reinecke* v. *Gardner,* where it said that the tax should be computed upon the cash basis unless the taxpayer "keeps his books on *an accrual basis which accurately reflects his income,* and actually made his return on that basis". The question is not whether the corporation kept its accounts and made its return upon *an* accrual basis or upon *the* accrual basis, but whether it kept its accounts and made its return upon a form or kind of an accrual basis which accurately reflected its income.

While the matter of valuing the inventories is separate and distinct from the treatment of items of receipts and disbursements, it does have some relation to the treatment thereof, for the reason that it is not feasible to use inventories at all unless the receipts and disbursements are accrued. To add or subtract the value of inventories to or from actual

receipts or actual disbursements would be wholly incongruous and the result would be wholly unintelligible.

If inventories are used in connection with any basis of accounting, the basis upon which they are valued affects the assignment of the net income to separate accounting periods, and the amount of the net income for each period, and affects the time as of which the net income is deemed to be earned. A change in the basis for valuing the inventories is just as much a change in the basis of accounting as a change in the basis for treating the receipts and disbursements.

The defendant's statement that the Commissioner did not disturb "the *basic* accrual system of accounting" and that "the accrual system *as corrected* [by the Commissioner] discloses respondents' true net income" (p. 28) demonstrates the fallacy which underlies the defendant's entire argument. Inasmuch as the Commissioner did disturb the valuation of the inventories, it is obvious that the system which the defendant calls the "basic accrual system" does not include the use or valuation of inventories. Inasmuch as the Commissioner did correct the valuation of the inventories, it is obvious that the system which the defendant calls the "accrual system" does include the use and valuation of inventories. The defendant's statement shows that the system which reflects the true net income is "the accrual system as corrected" by the Commissioner, and not the "basic accrual system" or the "accrual system" as used by the plaintiffs. It also shows that the system which did or did not clearly reflect the income was the "accrual system" which included the use of inventories, rather than the "basic accrual system" which did not include the use of inventories.

The system of accounting which the plaintiffs used included both the accrual of receipts and disbursements and the valuation of inventories. The matter of valuing the inventories was just as much a part, and just as essential a part, of the system as the matter of accruing receipts and disbursements. Neither part could be changed without changing the system of accounting. If either part failed to clearly reflect the income and comply with the Regulations,

it is obvious that the system failed to clearly reflect the income and comply with the Regulations.

The Circuit Court of Appeals for the Third Circuit held that the basis used by the plaintiffs did not reflect their true net incomes, because of the fact that they valued their inventories at a constant figure, regardless of cost or market value, that the "change by the Commissioner was not the mere or incidental change or correction of a figure in a system, but the change of a system, from one basis to a different basis", and that since the basis used by the plaintiffs did not reflect their true net income, the only basis which could be used under the Revenue Act was the cash basis prescribed in Section 12 (R. pp. 134-5).

There was no occasion for any specific finding to the effect that the basis upon which the plaintiffs kept their accounts and made their returns did not clearly reflect their incomes, because the facts which are established by the pleadings and the findings show conclusively that the basis used by the plaintiffs could not be used for income tax purposes under Section 13(*d*).

The findings show that the plaintiffs kept their accounts during 1917 upon the basis of accruing their receipts and disbursements, *and using inventories valued at a constant figure, regardless of cost or market value* (R. pp. 86, 107, 126), that the plaintiffs determined their incomes and made their returns for 1917 upon the basis upon which their accounts were kept and that the amount of the consolidated net income as so determined and returned was $17,994,400.46 including dividends (R. pp. 87, 107, 126).

The above facts were established by undisputed evidence, which was admitted without objection or exception taken by the defendant (R. pp. 33-5) and were conceded by the findings which the defendant requested the District Court to make (R. pp. 83, 104, 122). The defendant does not question any one of the above findings and apparently concedes that they were all supported by the evidence.

The pleadings and the findings show that the Commissioner objected to the basis upon which the plaintiffs valued

their inventories and determined their incomes and *revalued their inventories* and *redetermined their incomes upon a different basis,* and that the consolidated net income as so redetermined was $24,949,668.51 including dividends (R. pp. 3-4, 15, 98, 102, 117, 120), and that *the basis upon which the plaintiffs kept their accounts and made their returns for 1917 was not in accordance with the Regulations* which the Commissioner made, with the approval of the Secretary of the Treasury, *with respect to the valuation of inventories* (R. pp. 5, 15, 100, 102, 118, 120).

The above facts were conceded by the answers and also by the findings which the defendant requested the District Court to make (R. pp. 84, 85, 104, 105-6, 123, 124).

The pleadings and the findings thus show conclusively that the basis used by the plaintiffs did not clearly reflect the income and comply with the Regulations and could not be used for income tax purposes under Section 13(*d*).

The pleadings and the findings show in addition the rulings and determinations which the Commissioner made to the effect that the basis used by the plaintiffs did not clearly reflect their incomes or comply with the Regulations and that their incomes should not be determined upon such basis (R. pp. 5-6, 15, 100, 102, 118, 120, 84, 85, 104, 105-6, 123, 124). They show these rulings and determinations not as a conclusion of law or as a conclusion from other facts alleged or found, but as independent and separate facts. There is no warrant for the claim that the allegations or findings with respect to these rulings and determinations involved an interpretation of the letters of March 7, 1921 which the Commissioner wrote to the plaintiffs. The inference is that the Commissioner made his rulings and determinations before he wrote the letters. There is no ground to infer that he made them only by the letters. The plaintiffs did not offer any evidence with respect to these rulings and determinations because there was no occasion for them to prove allegations of the petitions which were admitted by the answers.

These rulings and determinations were made by the Com-

missioner in the performance of his duties and within the scope of his authority under the Revenue Act. Any such ruling or determination by an administrative officer is binding and conclusive upon the Government, unless it is impeached by the Government for fraud or other adequate cause.

U. S. v. *Kaufman*, 96 U. S. 567;
U. S. v. *Savings Bank*, 104 U. S. 728;
Steel v. *Smelting Co.*, 106 U. S. 447;
Lee v. *Johnson*, 116 U. S. 48;
Heath v. *Wallace*, 138 U. S. 573;
U. S. v. *California & Oregon Land Co.*, 148 U. S. 31;
Bates v. *Payne*, 194 U. S. 106;
Houston v. *Packing Co.*, 249 U. S. 479.

The defendant has made no attempt to impeach the rulings and determinations which the Commissioner made in the cases of these plaintiffs. The defendant does not even contend that they were erroneous or improper. The fact that the Commissioner made these rulings and determinations shows conclusively as a matter of law that the basis used by the plaintiffs could not be used for income tax purposes under Section 13(*d*).

It is well settled that findings of fact are sufficient to support a judgment if the facts found, together with such inferences as may properly be drawn therefrom, are sufficient to show that the judgment was correct. Even when a material fact is omitted, the judgment will be affirmed if such fact appears sufficiently from the other facts which are found.

United States v. *Pugh*, 99 U. S. 265;
Sun Mutual Ins. Co. v. *Ocean Ins. Co.*, 107 U. S. 485;
The Belgenland, 114 U. S. 355;
United States v. *California & Oregon Land Co.*, 148 U. S. 31;
Winton v. *Amos*, 255 U. S. 373.

We submit that the opinion of the Circuit Court of Appeals for the Second Circuit in *American Can Company* v.

Bowers wholly fails to meet the issues. This opinion does not recognize or meet the contentions which the plaintiffs actually made, although it undertakes to refute a number of contentions which the plaintiffs did not make. We contend that it does not interpret correctly either the facts or the law, and does not recognize the real purpose or effect of inventories. It does not undertake to interpret the word "basis" as used in Section 13(*d*) or to define the basis upon which the plaintiffs kept their accounts and made their returns, or to determine whether the basis used by the plaintiffs was one which clearly reflected their incomes. It holds in substance that the Commissioner had the power to redetermine the incomes in accordance with the Regulations, although it does not point to any provision of the Revenue Act which conferred any such power.

We have never argued or claimed that there is no occasion for reconciliation of the net profits of the plaintiffs as per their books with their Federal tax returns for 1917, or that the Commissioner was required under the law to compute their taxes upon their incomes as returned by them without correction. The contentions which we made in the New York cases are entirely consistent with those made in the cases at bar.

It is obvious that the report of the Ways and Means Committee of the House, referred to on page 23 of the defendant's brief, can have no bearing upon the interpretation of the Revenue Act of 1917 as it was finally enacted.

United States v. *Trans-Missouri Freight Assn.*, 166 U. S. 290, 318;
Standard Oil Co. v. *U. S.*, 221 U. S. 1, 50.

The quotation from the opinion of this Court in *United States* v. *Mitchell*, 271 U. S. 9, which is printed on page 24 of the defendant's brief, has nothing to do with the Revenue Act of 1917. That case arose under the Revenue Act of 1918 and this Court did not undertake in that case to say anything about the Revenue Act of 1917.

The case of *Vang* v. *Lewellyn*, 35 Fed. 2nd, 283, which is cited on page 24, and the cases cited on page 25, of the defendant's brief, were entirely different from the cases at bar. The taxpayers did not contend in any of those cases that their taxes should be computed upon the cash basis or even offer to prove the amounts of their incomes upon the cash basis. They contended on the contrary that their returns were correct as made. They did not prove that the taxes which they had paid were in excess of the taxes which were legally payable. There is nothing in any of these cases to throw any doubt upon the judgments in the cases at bar.

Treasury Decision 2433, to which the defendant refers at the bottom of page 25 of its brief, tends to confirm rather than question the contentions made by the plaintiffs. This decision merely provided that it would be *"permissible"* for corporations to make returns under Section 13(*d*) upon an accrual basis, provided that they made returns which clearly reflected their incomes, and used the same basis consistently year after year, and that if any corporation failed to so make its return it would not be permitted to make its return upon any basis other than the cash basis.

Treasury Decision No. 2609, referred to on page 4 of the defendant's brief, also tends to confirm the plaintiff's contentions, particularly the proviso at the end of paragraph A. The requirement that the method adopted for the valuation of inventories must be adhered to in subsequent years clearly shows that a change in the method for valuing the inventories would involve a change in the basis of accounting for the income.

POINT III.

The findings of fact established the net incomes of the plaintiffs upon the basis prescribed in Section 12 of the Revenue Act and are fully supported by the evidence.

The defendant does not point out or suggest that there is any defect in the findings of the District Court with respect to the incomes of the plaintiffs upon the cash basis. The defendant contends merely that the findings are not supported by the evidence because the evidence shows that the incomes upon the cash basis were not determined in accordance with Article 91 of Regulations 33 revised, *i. e.*, by the use of "sales", "purchases" and "inventories". The defendant does not, however, contend that the incomes of the plaintiffs upon the cash basis were not determined in accordance with Section 12 of the Revenue Act. It will be noted that the defendant's brief does not even make any reference to this section.

Section 12 requires and permits the use of only five factors in determining the amount of the net income (1) the gross amount of the income *received within the year,* (2) the amount of the ordinary and necessary expenses of maintenance and operation *paid within the year,* (3) the amount of the losses actually *sustained and charged off within the year,* (4) the amount of the interest on indebtedness *paid within the year,* and (5) the amount of the taxes *paid within the year.* The net income is ascertained under this Section by deducting the last four factors from the first factor.

The findings and the evidence show separately for each Company, and in the aggregate for all the Companies, the amount of each one of these five factors and that each factor includes the items and only the items which are included in the definition of the factor contained in Section 12. There is no ground for claiming that the amounts given for gross

income fail to include any item which ought to have been included or that the amounts given for the deductions include any item which ought not to have been included. The findings and the evidence show also the amount of the net income of each Company and the consolidated net income of all the Companies upon the cash basis prescribed in Section 12 (R. pp. 87-90, 108, 126-7, 35-9, 43-6, 59-64, 66-67).

When the plaintiffs offered in evidence their computation of their incomes upon the cash basis, the defendant asked for an opportunity to examine the books and records of the plaintiffs with a view to checking the correctness of their computation. The plaintiffs did not oppose this application and the Court adjourned the trial for several weeks in order to allow the defendant to check the computation. When the trial was resumed the defendant conceded the figures in the plaintiffs' computation, except for two items which the plaintiffs corrected. (R. pp. 38-40, 43-5).

The figures shown in the findings of fact are in exact accordance with the figures shown in the plaintiffs' computation as corrected to meet the objections of the defendant. The plaintiffs' computation was supported by the testimony of their chief accounting officer and the concessions of the defendant.

There is no warrant for the claim that it is necessary to comply with Article 91 of the Regulations or to compute the cost of goods sold in order to determine the net income of a corporation upon the basis prescribed in Section 12, for the simple reason that Section 12 does not require or permit the use of such factors as "sales," "cost," "purchases" or "inventories." These factors can be used only in connection with an accrual basis of accounting.

Article 91 of the Regulations is in conflict with Section 12 and cannot have the effect of changing the statute.

It is not possible to use accounts receivable, accounts payable or inventories in connection with the basis of actual receipts and disbursements because they are neither actual receipts nor actual disbursements.

The defendant's argument that Article 91 applies to the cash basis as well as an accrual basis would lead to the result that the income of a corporation upon the cash basis is the same as its income upon an accrual basis, which is palpably absurd.

It is well settled that when the income is determined upon the cash basis no items should be used or taken into consideration other than items of cash actually received within the year, items of cash actually paid within the year and losses actually sustained within the year.

Maryland Casualty Co. v. *U. S.*, 251 U. S. 342;
U. S. v. *Anderson*, 269 U. S. 422;
United States v. *Mitchell*, 271 U. S. 9;
Mutual Benefit Ins. Co. v. *Herold*, 198 Fed. Rep. 199 (D. C. N. J. 1912); 201 Fed. Rep. 918 (C. C. A. 3rd Cir.);
Connecticut General Life Insurance Co. v. *Eaton*, and *Connecticut Mutual Insurance Co.* v. *Eaton*, 218 Fed. Rep. 188, 206 (D. C. Conn.); affirmed on appeal, 223 Fed. Rep. 1022 (C. C. A. 2nd Cir.);
Edwards v. *Keith*, 231 Fed. Rep. 110 (C. C. A. 2nd Cir.);
U. S. v. *Christine Oil & Gas Co.*, 269 Fed. Rep. 458 (D. C. La.);
Lumber Mutual Fire Insurance Co. v. *Malley*, 256 Fed. Rep. 380 (D. C. Mass.);
Coley v. *Pickering*, 21 Fed. 2nd 247 (Dist. Ct. S. D. Ill.) 1927;
American Can Co. v. *Bowers*, (D. C. N. Y.) (Petition for certiorari p. 36);
Aluminum Castings Co. v. *Routzahn*, 24 Fed. 2nd 230 (D. C. Ohio); 31 Fed. 2nd 669 (C. C. A. 6th Cir.).

It may be true that the cash basis prescribed in Section 12 does not reflect the "true net income" of a manufacturing corporation, as was indicated by this Court in *United States*

v. *Anderson,* 269 U. S. 422, and *American National Company* v. *United States,* 274 U. S. 99, but the important point is that Congress did not levy the taxes for 1917 upon the "true net income" of corporations, leaving to the Commissioner or the Regulations the matter of determining the true net income. On the contrary, it levied the taxes for 1917 upon the incomes of corporations determined upon the basis prescribed in Section 12, except in cases which fell within the terms of Section 13(*d*). It does not make any difference whether the basis prescribed in Section 12 is one which reflects the "true net income". The Commissioner has no power to assess any tax unless he does so in accordance with the Revenue Act.

When Congress prescribed the cash basis for income tax purposes it probably considered that the cash basis would be the simplest and easiest basis for the great majority of taxpayers to use and for the Government agents to check. This is particularly true with respect to the multitude of small shopkeepers and tradesmen throughout the country, whether incorporated or not, who do not have their accounts kept or certified by skilled accountants. The matter of accruing receipts and disbursements and valuing inventories involves to some extent questions of opinion and judgment with respect to which different business men may honestly differ, while the cash basis involves only a mathematical computation. The cash basis would in the long run reflect the true net income of taxpayers just as accurately as any other basis, and inasmuch as the taxes were payable in cash it was reasonable for Congress to levy them only upon the cash income actually received.

That the use of inventories is a departure from the basis of actual receipts and disbursements was recognized in the argument of the Solicitor General in behalf of the Government in *United States* v. *Anderson,* 269 U. S. 422. It was there stated (p. 423):

> "The first corporation income tax Act of October 3, 1913, like the 1909 Act, provided for the calculation of net taxable income on the receipts and disbursements

basis. Under these two Acts some *departures* from the strict receipts and disbursements basis was permitted by the Commissioner of Internal Revenue, *such as the use of inventories* * * * The resulting system was a *mongrel* one."

That inventories are not used when income is determined on the basis of actual receipts and disbursements, has frequently been recognized by the Commissioner of Internal Revenue. In 1921 the Commissioner issued T. D. 3104 which added a new article to Regulations 45 issued under the Revenue Act of 1918. The first sentence of this article read as follows:

"Art. 1585(a). *Inventories of live-stock raisers and other farmers.* (1) Farmers may *change* the basis of their returns from that of *receipts and disbursements* to that of an *inventory* basis, which necessitates the use of opening and closing *inventories* for the year in which the change is made" (4 C. B. 52).

He later issued O. D. 841, the first sentence of which read as follows:

"It is not contemplated by Treasury Decision 3104 that farmers must obtain formal permission in order to *change* the basis of their returns from that of *receipts and disbursements* to that of an *inventory basis*" (4 C. B. 53).

He later issued O. D. 939 which reads in part as follows:

"Where a change is made by farmers in the basis of making their returns from that of *cash receipts and disbursements* to that of an *accrual basis with inventories,* many items of gross income and deductions may be duplicated or entirely omitted as a result of the change unless an adjustment is made of the net income for the prior years, * * * It is therefore not permissible for farmers *in changing to the inventory basis* of making their returns to make adjustments by calculating their net income for the current taxable year without taking as a credit the *inventory* of live stock, crops, and other products at the beginning of the year in accordance with the instructions on page 4 of Form 1040-F" (4 C. B. 54).

There is no evidence to show how the plaintiffs determined the amounts of the expenses of maintenance and operation shown in their computation or how much, if anything was included for purchases of tin plate. The fact that the plaintiffs had on hand more tin plate at the end of 1917 than at the beginning of 1917 is of no importance whatever. The evidence shows that they had on hand less tin plate at the end of 1916 than at the beginning of 1916 (R. p. 54). It is obvious that their stocks had been diminished during 1916 and natural that they should increase their stocks during 1917. However, the record shows conclusively that the amounts given for expenses included nothing other than the amounts defined in Section 12 and that they were correct.

There is nothing in *Doyle* v. *Mitchell Brothers,* 247 U. S. 179, or *Hays* v. *Gauley Mountain Coal Co.,* 247 U. S. 189, which throws any doubt upon the plaintiffs' computation of their income upon the cash basis. These cases involve only the matter of determining the income derived through the sale of *capital assets* under the Revenue Act of 1909. The Government contended that the entire proceeds of the sale of the capital assets were income and that if the taxpayers had the right to deduct anything therefrom they had the right to deduct only the original cost which was less than the market value on December 31, 1908, when the Revenue Act took effect. The taxpayers contended that they had the right to deduct the market value of the assets on December 31, 1908. This Court referred to various Regulations, some with respect to the determination of the income of a manufacturing corporation, and others with respect to the determination of the income derived through the sale of capital assets. Those which related to the capital assets were in accordance with the taxpayers' contention and this Court held that the taxpayers' contentions were correct. There is no doubt that this Court approved the Regulations which related to the capital assets, but there is no ground for saying that it approved the Regulations which related to the incomes of manufacturing corporations.

The difference between capital assets and income assets is obvious. The proceeds of the sale of capital assets are not income receipts. They do not represent income in any sense unless they include a profit. On the other hand, the proceeds of the sale of income assets, such as manufactured products, are income receipts.

It is obvious that if the net income of a corporation is determined upon an accrual basis for 1916 and upon the cash basis for 1917, receipts and disbursements which are accrued at the end of 1916 will be included in both calculations. The effect is to include in the income for each year the net income accrued at the end of the first year. This fact, however, can have no bearing upon the interpretation of Section 12 or the matter of determining the income for 1917 in accordance with that section.

POINT IV.

The plaintiffs are entitled to judgments for the amounts of the taxes paid in excess of the amounts payable upon the cash basis, with interest at the rate of six per cent per annum from the dates of payment to a date preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner of Internal Revenue.

It is well settled that an erroneous return is not binding upon the taxpayer any more than upon the Government, and that if a taxpayer pays an amount of taxes in excess of the amount which was legally payable he has the right to recover back the excess, regardless of the reason for the overpayment, and regardless of whether it was made voluntarily or under protest or duress.

Revenue Act of 1916, 39 Stat. 756 c. 463, Sec. 14(a);

Revenue Act of 1918, 40 Stat. 1057 c. 18, Sec. 252;

Revenue Act of 1921, 42 Stat. 227 c. 136, Sec. 252;

Revenue Act of 1924, 43 Stat. 253 c. 234, Sec. 281(a), Sec. 1014;

Revenue Act of 1926, 44 Stat. 9 c. 27, Sec. 284, Sec. 1122(c);

Judicial Code, as amended Feb. 24, 1925, Sec. 24, par. 20;

U. S. v. *Hvoslef,* 237 U. S. 1;

Capewell Horse Nail Company v. *Walsh,* 1 Fed. 2nd 818 (D. C. Conn.); 4 Fed. 2nd 991 (C. C. A., 2nd Cir.);

Beatty v. *Heiner,* 10 Fed. 2nd 390 (D. C. Pa.);

Warner v. *Walsh,* 24 Fed. 2nd 449 (D. C. Conn.);

Baker & Taylor Co. v. *U. S.,* 26 Fed. 2nd 187 (C. C. A., 2nd Cir.).

After the Circuit Court of Appeals had entered judgments of affirmance, the plaintiffs moved for the amendment of the judgments so as to comply with Section 177 of the Judicial Code as amended by Section 615 of the Revenue Act of 1928, which changed the rule with respect to the allowance of interest on claims of this character and directed that a provision with respect to the allowance of interest should be included in every judgment. The Circuit Court of Appeals entered orders amending their judgments *nunc pro tunc* so as to comply with Section 177 of the Judicial Code as so amended and state the exact amounts of the overpayments of the taxes and the dates from which and to which interest thereon should be paid (R. pp. 139-142).

If this Court should affirm the judgments of the Circuit Court of Appeals as so amended, the matter of the allowance of interest would be covered. If, however, it should affirm the judgments of the District Court, we suggest that this Court should include in its judgments provisions with respect to the allowance of interest, in accordance with Section 177 of the Judicial Code as amended, so that the mandates to the District Court would include similar provisions. If this Court should merely affirm the judgments of the District Court without including such provision for interest, the District Court might be in doubt with respect to the interpretation of the mandates and consequently in doubt as to whether its judgments to be entered on the mandates should or should not include such provisions for interest.

Section 177 of the Judicial Code as amended by the Revenue Act of 1928 took effect on June 29, 1928. It included the following:

> "(b) In any judgment of any court rendered (whether against the United States, a collector or deputy collector of internal revenue, a former collector or deputy collector, or the personal representative in case of death) for any overpayment in respect of any internal-revenue tax, interest shall be allowed at the rate of 6 per centum per annum upon the amount of the overpayment, from the date of the payment or collection thereof to a date

preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner of Internal Revenue."

The judgments of the District Court in the cases at bar ere entered on August 16, 1927. They included interest the rate of six per cent per annum from the dates of the verpayments to the dates of entry of the judgments (R. p. 91, 110, 128). This was in accordance with Section 177 the Judicial Code as amended by the Revenue Act of 1926, hich provided that interest should be allowed at the rate of x per cent per annum from the date of the overpayment the date of the entry of the judgment or if the judgment as reviewed by an Appellate Court to the date of entry of he final judgment.

The Tucker Act as amended February 13, 1925 and ncorporated in the United States Code on June 30, 1926, rovided that from the date of the final judgment or decree gainst the United States interest should be computed thereon t the rate of four per cent until the time when an appropria-ion was made for the payment of the judgment or decree 24 Stat. 507, Sec. 10; 43 Stat. 940, Sec. 8).

It is obvious that Section 177 of the Judicial Code as mended by the Revenue Act of 1928 was intended to super-ede all previous provisions with respect to interest on claims f this character and was intended to apply to all judgments endered after the amendment took effect, including judg-nents entered in the first instance by a Trial Court, judg-nents entered by an Appellate Court and judgments entered y the Trial Court upon the mandate of an Appellate Court.

Conclusion.

The only returns which the Revenue Act authorized or required the plaintiffs to make were returns upon the cash basis. The returns which the plaintiffs made were more favorable to the Government than the returns which the Revenue Act authorized and required them to make. The effect of allowing the plaintiffs to recover the taxes which they paid in excess of the taxes payable upon the cash basis, with interest from the dates of payment, is merely to put the plaintiffs in the position where they would have been if they had made, in the first instance, the returns which the Revenue Act authorized and required them to make. The inherent justice of allowing such a recovery is self evident.

Respectfully submitted,

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